

Summary Analysis of Amended Bill

Author: Atkins Sponsor: Bill Number: SB 451

Analyst: Jessica Deitchman Phone: (916) 845-6310 Amended: April 8, 2019 and

May 21, 2019

Attorney: Shane Hofeling Related Bills: See Prior Analysis

Subject: Rehabilitation of Certified Historic Building Credit

Summary

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), allow a tax credit for a portion of the costs paid or incurred to rehabilitate certain historic structures.

This analysis only addresses the provisions of the bill that impact the department's programs and operations.

Recommendation – No position.

Summary of Amendments

The April 8, 2019, amendments made changes to require the entire credit to be claimed the first year the structure is placed in service. The May 21, 2019, amendments modified the amount of credit that may be allocated to each type of building and added language to allow the credit only upon appropriation of the credit as part of the budget. As a result of the amendments, the "Effective/Operative Date," "This Bill, "Implementation considerations," and "Economic Impact" sections in the department's analysis of the bill as introduced February 21, 2019, have been revised and the implementation and technical considerations have been resolved. The remainder of that analysis still applies. The fiscal impact section is restated for convenience.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2021, and before January 1, 2026, when the credit is included as an appropriation in the budget.

This Bill

For taxable years beginning on or after January 1, 2021, and before January 1, 2026, this bill would create a tax credit for the rehabilitation expenses of certain homes and historic buildings determined in accordance with federal law (section 47 of the IRC) except as follows:

 A general 20 percent credit would be allowed for the qualified rehabilitation expenditures of a certified historic structure (other than expenses that qualify for the 25 percent credit), and

Bill Number: SB 451

- A 25 percent credit would be allowed for the qualified rehabilitation expenditures of a certified historic structure if that structure meets any of the following conditions:
 - The rehabilitated structure is located on certain federal surplus property, surplus state real property, or on surplus land.
 - The rehabilitated structure includes affordable housing for lowerincome households.¹
 - The structure is located in a designated census tract.²
 - o The structure is part of a military base reuse authority.3
 - The structure is a transit-oriented development that is a higher-density, mixed-use development within a walking distance of one-half mile of a transit station.

Unlike the federal credit;

- A state credit would be unavailable for expenditures with respect to a qualified building unless it is a certified historic structure, and
- A state credit would be allowed for qualified rehabilitation expenditure amounts for an owner-occupied residence if:
 - The expenses are determined to have a public benefit in the year of completion, and
 - The credit amount is equal to or more than \$5,000 but do not exceed \$25,000.
- The state credit is zero dollars unless appropriations are provided in a bill related to the Budget Act.

¹ As defined in Section 50079.5 of the Health and Safety Code.

² As defined in paragraph (7) of subdivision (b) of Section 17053.73 of the Revenue and Taxation Code (R&TC).

³ Established pursuant to Title 7.86 (commencing with Section 67800 of the Government Code).

 "Certified historic structure" would have the same meaning as defined in Section 47(c)(3) of the IRC, that is a structure in this state and is listed on the California Register of Historical Resources.

Bill Number: SB 451

- "Qualified rehabilitation expenditure" would have the same meaning as that term is defined in Section 47(c)(2) of the IRC, except that qualified rehabilitation expenditures may include expenditures in connection with the rehabilitation of a building without regard to whether any portion of that building is or is reasonably expected to be a tax-exempt use property.
- "Qualified rehabilitation expenditure" has the same meaning as that term is
 defined in Section 47(c)(2) of the IRC and also means rehabilitation
 expenditures incurred by the taxpayer with respect to a qualified residence for
 the rehabilitation of the exterior of the building or rehabilitation necessary for the
 function of that home, including, but not limited to, rehabilitation of electrical,
 plumbing, or foundation of the qualified residence.

The California Tax Credit Allocation Committee (Allocation Committee), with assistance from the Office of Historic Preservation, would be required to do the following:

- Allocate and certify tax credits.
- Establish application procedures.
- Establish criteria consistent with the requirements of this bill.
- Determine and designate applicants that meet the requirements of this bill.
- Process and approve, or reject, all applications.
- Allocate an aggregate amount of credits, subject to the annual cap, equal to the sum of all of the following:
 - \$50,000,000 in tax credits for the 2021 calendar year and each calendar year thereafter, through and including the 2026 calendar year.
 - o The unused allocation tax credit amount, if any, for the preceding calendar year.
- Set aside \$10,000,000 of tax credits that may be allocated each calendar year as follows:
 - \$2,000,000 of tax credits for taxpayers with qualified rehabilitation expenditures for a certified historic structure that is a qualified residence. To the extent that this amount if not fully allocated in any calendar year, the unused portion shall become available in subsequent calendar years for allocation to other taxpayers with qualified rehabilitation expenditures for a certified historic structure that is a qualified residence.

\$8,000,000 of tax credits for taxpayers with qualified rehabilitation expenditures of less than \$1,000,000 for any other certified historic building that is not a qualified residence. To the extent that this amount is not fully allocated in any calendar year, the unused portion shall become available for allocation to other taxpayers, except those that are using the credit to rehabilitate a qualified residence.

Bill Number: SB 451

- Allocate credits awarded to a partnership to the partners of that partnership in accordance with the partnership agreement, independent of how the allocation was done for federal purposes and without regard to the federal rule requiring substantial economic effect for partnership allocations under Section 704(b) of the IRC.
- Provide the Franchise Tax Board an annual list of the taxpayers that were allocated a credit, including each taxpayer's taxpayer identification number, and the amount allocated to each taxpayer.
- Establish procedures for the recapture of amounts allocated for a tax credit allowed to a taxpayer for the rehabilitation of a qualified residence if the taxpayer does not use the qualified residence as his or her principal residence within two years after the rehabilitation of the residence.
- Adopt a reasonable fee in an amount sufficient to cover expenses.

In addition, this bill would specify the following:

- No deduction would be allowed for that expense for which this credit is allowed, and if a credit is allowed with respect to property, the basis of that property would be reduced by the amount of the credit.
- Any unused credits could be carried over for up to eight years.
- The credit could reduce the regular tax plus the tax relating to the separate tax on lump-sum distributions, below tentative minimum tax for taxpayers subject to the PITL and the CTL.
- Section 47(c)(1)(B)(ii) of the IRC, relating to special rules for rehabilitation that
 may be expected to be completed in phases would not apply.
- The recapture provisions described in subsection (a) of Section 50 of the IRC would apply when the property (or interest in the property) is sold within the recapture period.⁴
- The credit provisions would remain in effect regardless of the expiration or repeal of Section 47 of the IRC, relating to the federal rehabilitation credit.

⁴ The compliance and recapture period for the federal historic credits is five years from the date the property is placed in service. Twenty percent of the recapture risk decreases each year.

Bill Number: SB 451

The bill specifies that the unlike the federal credit, the entire credit generated shall be claimed the year the building is placed in service.

The tax credit provisions⁵ would remain in effect until December 1, 2026, and as of that date would be repealed.

Implementation Considerations

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional concerns may be identified as the bill moves through the legislative process. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill would require that the credit be claimed in the year that the building is "placed in service." This would mean that no credit could be claimed until the rehabilitation has been completed and the building is available to be used for its designated purpose. If this is contrary to the author's intent, the bill should be amended.

Fiscal Impact

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 451 as Amended May 21, 2019 Assumed Enactment after June 30, 2019

(\$ in Millions)

Fiscal Year	Revenue
2019-2020	\$0
2020-2021	\$0
2021-2022	\$0

Page 5

⁵ R&TC sections 17053.91 and 23691.

Credits allocated in 2021 cannot be used until after the building has been placed into service. As a result, credit usage would not begin until 2023.

This estimate assumes a specific appropriation of funds that would be enacted in 2021, and each year thereafter, up to 2026.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Revenue Discussion

This bill would authorize the California Tax Credit Allocation Committee (Allocation Committee) to allocate \$50 million annually for the rehabilitation of certified historic structures in California from January 1, 2021, through January 1, 2026. Based on the federal historic tax credit usage as well as historical data on qualifying rehabilitation expenses, it is assumed that the credit would be fully allocated each year by the Allocation Committee. It is assumed that five percent, or \$2.5 million, of the allocation would ultimately be returned to the Allocation Committee due to unforeseen project issues and added to the allocation amount in the following year. Allocated credits cannot be used until after the building has been placed into service. As a result, credit usage would not begin until 2023. It is estimated that the total credit generated for taxable year 2023 would be \$43 million. It is assumed that, 90 percent, including the S corporation adjustment, or \$39 million, would be earned by taxpayers who have a tax liability to offset with the credit. Of those, it is estimated that 70 percent, or \$27 million, would be claimed in the year generated and the remaining credit would be claimed over the next several years.

To arrive at the offsetting tax effect of the expense deduction that would otherwise be allowed under current law, it is estimated that qualified taxpayers would be unable to deduct approximately \$43 million in qualified expenses in taxable year 2023. Applying an average tax rate of 7 percent results in an offsetting revenue gain of \$3 million. The resulting net revenue loss, for taxable year 2023, would be \$24 million. The amount of the loss would peak at \$36 million in taxable year 2027.

The tax year estimates are converted to fiscal year revenue estimates, rounded and reflected in the above table.

Legislative Staff Contact

Jessica Deitchman Legislative Analyst, FTB (916) 845-6310 jessica.deitchman@ftb.ca.gov Jame Eiserman Revenue Manager, FTB (916) 845-7484 jame.eiserman@ftb.ca.gov Jahna Carlson Acting Legislative Director, FTB (916) 845-5683 jahna.carlson@ftb.ca.gov

Bill Number: SB 451